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IN THE

Supreme Court of the United States

ERNST & YOUNG and ERNST & YOUNG LLP,

Petitioners,

—v.—

BANKRUPTCY SERVICES, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

GREGORY J. WALLANCE
Counsel of Record
RICHARD G. SMOLEV
ROBERT GRASS
ELISABETH KANN
AARON MINER
LAUREN ATTARD
KAYE SCHOLER LLP
425 Park Avenue
New York, New York 10021
(212) 836-8000

Attorneys for Respondent

QUESTIONS PRESENTED

1. Whether this Court should reconsider its ruling in *Katchen v. Landy*, 382 U.S. 323 (1966) that *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500 (1959) does not apply in bankruptcy proceedings given that the features of the bankruptcy scheme underpinning *Katchen* have not substantially changed.

2. Whether the Seventh Amendment requires different treatment of bankruptcy trustee avoiding powers claims and compulsory common law counterclaims against a creditor, where the issues raised by both types of claims are integral to the equitable claims allowance process in bankruptcy court that the creditor triggered by filing a proof of claim.

CORPORATE DISCLOSURE STATEMENT PURSUANT TO SUPREME COURT RULE 29.6

Epiq Bankruptcy Solutions, LLC, formerly known as Bankruptcy Services, LLC, states that Epiq Bankruptcy Solutions, LLC is wholly owned by Epiq Systems Acquisition, Inc., which is wholly owned by Epiq Systems, Inc., a publicly held corporation.

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BRIEF IN OPPOSITION

Bankruptcy Services Inc. ("BSI") respectfully opposes the Petition for a Writ of Certiorari (the "Petition") filed by Ernst & Young and Ernst & Young LLP ("E&Y").

OPINIONS BELOW

BSI appends the bankruptcy court's unreported findings of fact and conclusions of law as to damages (BSI App., *infra*, 1a-25a).

CONSTITUTIONAL PROVISIONS INVOLVED

Article I, Section 8 of the United States Constitution provides, in relevant part:

> The Congress shall have power * * * To establish * * * uniform laws on the subject of Bankruptcies throughout the United States * * *.

The Seventh Amendment of the United States Constitution provides, in relevant part:

> In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved * * *.

INTRODUCTION

By its Petition, E&Y seeks to have this Court overrule its well-settled and well-reasoned precedents

regarding the application of the Seventh Amendment in the context of a bankruptcy trustee's compulsory common law counterclaim that also serves as an objection to a creditor's proof of claim filed in the bankruptcy court. E&Y seeks certiorari on these questions even though the court of appeals remanded the case to the district court to rule on additional issues that may moot the questions presented, there is no dispute among the courts of appeals regarding the questions presented, and there is otherwise no reason for this Court to reconsider its precedents.

First, this Court should deny certiorari from the Second Circuit's interlocutory judgment because, on remand, rulings of the district court and, ultimately, the court of appeals may make it unnecessary for this Court to resolve the constitutional issues presented by the Petition. Consideration of those issues at this stage of the proceedings would violate this Court's deeply-rooted doctrine that it will not decide constitutional issues unless their adjudication is unavoidable.

Second, there is no conflict among the courts of appeals with respect to the questions presented. In fact, the lower courts have applied this Court's Seventh Amendment jurisprudence consistently with the Second Circuit. Pet. at 31-32 n.8.[1]

Third, the Second Circuit's decision confirms the well-settled equity jurisdiction of bankruptcy

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[1] "Pet." refers to the Petition. "App." refers to the Appendix annexed to the Petition.

courts, which is "essential to the performance of the duties imposed" on bankruptcy courts, to resolve without juries all creditors' proofs of claims and all objections, including those asserted as counterclaims seeking affirmative relief, that become part of the claims-allowance process. *Katchen v. Landy*, 382 U.S. 323, 329 (1966); *see Langenkamp v. Culp*, 498 U.S. 42, 44 (1990); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 58 (1989). Those essential duties are at the heart of the bankruptcy court's equitable powers.

E&Y nevertheless contends that *Katchen* should be overruled to the extent that it held that the rule of *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500 (1959), and *Dairy Queen, Inc. v. Wood*, 369 U.S. 469 (1962), does not apply in bankruptcy where, as here, the same facts support a bankruptcy trustee's common law counterclaim as well as its objection to a creditor proof of claim. E&Y's argument is based on the mistaken premise that the current bankruptcy regime changed the one in effect at the time *Katchen* was decided and, for the first time, permitted the district court to act as a unified court to hear equitable and legal claims asserted in a bankruptcy proceeding. In fact, district courts had those powers when this Court decided *Katchen*, which remains vital to the efficient functioning of the bankruptcy system.

E&Y further contends that *Katchen* should be limited to claims invoking a trustee's avoiding powers as compared with a trustee's counterclaims based on common law. E&Y's rationale is that jury trial rights are not available to creditors holding preferences or who received fraudulent conveyances because those

creditors have "unclean hands." Even apart from the absence of support in *Katchen*, *Granfinanciera*, and *Langenkamp*, E&Y's "unclean hands" theory does not support the purported distinction between avoiding powers claims and compulsory common law counterclaims and, as an analytical tool for determining the applicability of the Seventh Amendment in the bankruptcy process, the "unclean hands" doctrine is conceptually flawed and highly impractical.

Rather, as the Court's precedents make clear, by filing a claim, a creditor triggers an elemental bankruptcy function, the equitable process of allowing or disallowing claims against the estate. As a result, issues necessary to the allowance or disallowance of a creditor's claim – whether asserted by a trustee as an objection alone or as an objection in the form of a counterclaim – must be resolved in an equitable proceeding without a jury. Given the equitable nature of the claims allowance process and its importance to the proper functioning of the bankruptcy regime, this is the case whether the counterclaim is based on avoiding powers or, as here, is a common law compulsory counterclaim arising from, and intertwined with, the facts underlying a trustee's objection to a creditor's proof of claim and the proof of claim itself.

E&Y's proposal to send the claims allowance process to the district court for resolution by jury trial whenever a trustee asserts a compulsory common law counterclaim in combination with an objection is not required by the Seventh Amendment because the claims allowance process is equitable in nature, would strip a core bankruptcy function from the

bankruptcy process and thereby dismember the Congressional bankruptcy scheme, and would overburden the district courts, all at a time when the nation's economy, which depends on an efficient bankruptcy process, is under great stress.

STATEMENT OF THE CASE

In August 1994, CBI Holding Company, Inc., a wholesale pharmaceutical distributor, and certain of its subsidiaries (collectively, "CBI") filed petitions for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. The bankruptcy court appointed BSI as disbursing agent under the Plan of Reorganization (the "Plan"). Under the Plan, as disbursing agent, BSI succeeded to the claims of CBI, including its claims against E&Y, which had performed auditing services for CBI from 1990 through 1994 (the "CBI Claims"). In addition, under the Plan, BSI obtained an assignment of the claims of Trust Company of the West (with its affiliates "TCW"), a 48% shareholder of CBI, including its claims against E&Y (the "TCW Claims").

In January 1995, E&Y filed a proof of claim for unpaid "professional services rendered in 1993 and 1994" to CBI in connection with the "audit of [CBI]'s financial statements and other special engagements." App. 9a. In June 1995, the Official Unsecured Creditors' Committee (the "Creditors' Committee") filed an objection to E&Y's proof of claim, which the Creditors' Committee assigned to BSI. On October 16, 1996, BSI, in its capacity as disbursing agent on behalf of

CBI and also in its separate capacity as the assignee of TCW's claims, filed compulsory counterclaims against E&Y, *inter alia*, pursuant to 28 U.S.C. §§ 157(b)(2)(B) and (C), which respectively provide for bankruptcy court jurisdiction over the allowance or disallowance of claims against the estate and counterclaims by the estate against persons filing claims against the estate. App. 10a-11a.

BSI's counterclaims alleged, among other things, that E&Y was not entitled to fees for the services described in its proof of claim and was liable to CBI and TCW for damages because E&Y had committed professional malpractice and fraud that caused CBI's financial collapse. With respect to the CBI Claims, BSI sought damages and expungement of E&Y's proof of claim by virtue of, *inter alia*, E&Y's breach of Generally Accepted Auditing Standards ("GAAS") in performing the audit. App. 88a-89a. With respect to the TCW Claims, BSI sought damages.

On April 5, 2000, after a bench trial on liability, the bankruptcy court found E&Y liable on both the CBI and TCW Claims for professional malpractice and fraud for, among other things, failing to detect millions of dollars in unrecorded liabilities during the 1992 and 1993 audits. *Bankr. Servs., Inc. v. Ernst & Young (In re CBI Holding Co.)*, 247 B.R. 341, 348, 351 (Bankr. S.D.N.Y. 2000). The bankruptcy court found that E&Y lacked the requisite independence, failed to perform a search for unrecorded liabilities consistent with its own audit plan, and failed to conduct the audits in accordance with GAAS. *Id.* at 362-364. The bankruptcy court further found that E&Y's malprac-

tice and fraud was the proximate cause of CBI's bankruptcy. *Id.* at 364.

On November 6, 2000, after a separate bench trial on damages, the bankruptcy court entered a $70.1 million judgment, which was the sum of approximately $44.7 million awarded on the CBI Claims and approximately $25.4 million awarded on the TCW Claims. The bankruptcy court also expunged E&Y's proof of claim seeking payment of fees from CBI. App. 12a n.3, 15a-16a.

On June 30, 2004, the district court affirmed the bankruptcy court judgment with respect to the CBI Claims in part, but reversed the bankruptcy court judgment with respect to the TCW Claims. App. 129a-130a. The district court held that E&Y did not have a Seventh Amendment right to a jury trial on the CBI Claims "because BSI's success on those claims would result in the disallowance of Ernst & Young's Proof of Claim," but did have a Seventh Amendment right to a jury trial on the TCW Claims "because they would not themselves directly affect the allowance or disallowance of the Proof of Claim," and vacated the TCW part of the judgment. App. 100a, 105a.

On October 25, 2004, the district court granted E&Y's motion for rehearing, vacated the bankruptcy court judgment in full on the ground that BSI lacked standing and entered judgment in E&Y's favor. App. 81a. At the same time, the district court held that "[b]ecause CBI's claim for expungement of Ernst & Young's Proof of Claim is premised upon CBI's allegations of fraud, breach of contract, and negligence, CBI's expungement claim necessarily fails." App.

81a. In light of the district court's holding that BSI lacked standing to assert the CBI and TCW Claims, the district court did not consider several alternative grounds that E&Y had offered in support of its appeal to vacate the bankruptcy court judgment on the Claims.

BSI appealed to the Second Circuit the district court's ruling that BSI lacked standing to assert the Claims, but did not appeal the district court's ruling that E&Y was entitled to a jury trial on the TCW Claims. E&Y cross-appealed on the ground, among others, that even if BSI had standing to assert the CBI and TCW Claims, the judgment on the CBI Claims should nonetheless be vacated because the Seventh Amendment entitled it to a jury trial of those Claims or, alternatively, that the Seventh Amendment required that the jury trial of the legal claims (the TCW Claims) precede any bench trial of the equitable claims (the CBI Claims) because there were factual issues common to both.

On June 16, 2008, the Second Circuit unanimously reversed in part, holding that BSI had standing to assert the CBI and TCW Claims, affirmed the district court's ruling that E&Y was entitled to a jury trial on the TCW Claims, and remanded for further proceedings. App. 68a-69a. In doing so, the Second Circuit rejected E&Y's Seventh Amendment arguments that were the subject of its cross-appeal. *Id.*

First, relying on this Court's decisions in *Granfinanciera* and *Langenkamp*, the Second Circuit held that "a creditor who files" a proof of claim, thereby "trigger[ing] the process of 'allowance and disallowance of claims' . . . subjects itself to the bankruptcy

court's equitable jurisdiction in proceedings affecting that claim." App. 62a (quoting *Granfinanciera*, 492 U.S. at 58.). The Second Circuit further held that, in doing so, "a creditor loses its jury trial right only with respect to claims whose resolution affects the allowance or disallowance of the creditor's proof of claim or is otherwise so integral to restructuring the debtor-creditor relationship." App. 63a. Applying those principles, the Second Circuit concluded that E&Y was not entitled to a jury trial on the CBI Claims because "E & Y filed a proof of claim against CBI; the CBI claims were asserted in response to that proof of claim; and, insofar as we have already held that the CBI claims are either defenses to E & Y's fees claim or integrally related to those defenses, the resolution of the CBI claims clearly affects the structuring of the debtor-creditor relationship between CBI and E & Y." App. 63a.

Second, the Second Circuit rejected E&Y's alternative argument that it was entitled to a jury trial on the TCW Claims prior to a bench trial on the equitable CBI Claims. The court of appeals held that E&Y's argument was inconsistent with this Court's holding in *Katchen* "that it was permissible for a bankruptcy court to hold a bench trial on an equitable claim, even if its judgment would have res judicata effect on factual issues common to a jury triable legal claim, without violating the Seventh Amendment." App. 66a.

On October 15, 2008, without dissent, the Second Circuit denied E&Y's petition for rehearing and rehearing *en banc*. App. 163a-64a.

REASONS FOR DENYING THE PETITION

I. THE SECOND CIRCUIT REMANDED FOR FURTHER PROCEEDINGS THAT MAY MOOT THE ISSUES RAISED BY THE PETITION AND THEREFORE MAKE IT UNNECESSARY FOR THE COURT TO DECIDE CONSTITUTIONAL ISSUES

"'The Court will not pass upon a constitutional question although properly presented by the record, if there is also present some other ground upon which the case may be disposed of.'" *Pearson v. Callahan*, 129 S. Ct. 808, 821 (2009) (quoting *Ashwander v. Tenn. Valley Auth.*, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring)); *see also Va. Military Inst. v. United States*, 508 U.S. 946, 946 (1993) ("We generally await final judgment in the lower courts before exercising our certiorari jurisdiction.") (Scalia, J., concurring).

At this procedural stage, the constitutional adjudication sought by E&Y – expansion of the Seventh Amendment right to trial by jury in bankruptcy proceedings far beyond any holding of this Court – violates these cautionary principles. After remand from the court of appeals to the district court, E&Y reasserted several alternative, potentially *dispositive* legal arguments on its appeal seeking reversal of the bankruptcy court's judgment on the CBI Claims that neither the district court nor the court of appeals previously had considered. *Ernst & Young v. CBI Holding Co., Inc. (In re CBI Holding Co., Inc.)*, 2008 U.S. Dist. LEXIS 92558, at *4 (S.D.N.Y. Nov. 6, 2008) ("E&Y responds that judgment on the CBI Claims is

premature because it still has appeals of the bankruptcy court's decision pending before this Court."). If the lower courts rule in E&Y's favor on those issues, none of which are of a constitutional dimension, the constitutional questions presented by the Petition will be moot.

This Court's grants of certiorari prior to final judgment in *Beacon Theatres* and *Dairy Queen* do not support the same result here. In both cases, the petitioners sought review from the denial of a writ of mandamus seeking to compel a jury trial in the lower court before any trial had been conducted and, therefore, relief vindicating the petitioners' Seventh Amendment rights to a jury trial could be awarded *ex ante*. E&Y did not seek a writ of mandamus in this case but rather, in contrast to *Beacon Theatres and Dairy Queen*, E&Y seeks reversal of the *outcome* of a trial that took place *nine years* ago. Because the trial on the CBI Claims is completed and a judgment was rendered, any alleged denial of E&Y's constitutional right has already occurred, and there is no need for review now when the constitutional questions presented might be mooted by further proceedings in the lower courts.[2]

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[2] Even if the district court affirms the bankruptcy court's judgment on the CBI Claims, the questions presented might still become moot as to the TCW Claims. In that event, the district court must consider the collateral estoppel effect of such a judgment in a subsequent jury trial of the TCW Claims. If E&Y prevails at a subsequent jury trial of the TCW Claims on an issue found not to have been precluded by the judgment on the CBI Claims, the questions presented as to the TCW Claims will become moot.

II. THERE IS NO CONFLICT AMONG THE CIRCUITS THAT REQUIRES RESOLUTION

E&Y has not identified any decision of another court of appeals (or any other court) that conflicts with the Second Circuit's decision in this case. Other lower courts that have considered the questions presented by the Petition have resolved them in the same manner as the Second Circuit. *See* Pet. at 31-32 n.8.[3] Most recently, the Third Circuit, relying on *Katchen*, *Granfinanciera*, and *Langenkamp*, held that a creditor that "filed a proof of claim against [a debtor's] estate . . . was not constitutionally entitled to a jury trial on the Trustee's related breach of contract claim." *Schubert v. Lucent Techs.* (*In re Winstar Commc'ns, Inc.*), 554 F.3d 382, 406-07 (3d Cir. 2009); *accord SNA Nut Co. v. Haagen-Dazs Co., Inc.*, 302 F.3d 725, 730 (7th Cir. 2002) (finding no right to jury trial of trustee's state common law counterclaim for breach of contract and stating that "[o]nce a party has triggered this process of allowance and disallowance of claims, that party has subjected itself to the bankruptcy court's equitable jurisdiction and thus can no longer demand a right to a trial by jury"); *Institut Pasteur v. Cambridge Biotech Corp.*

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[3] E&Y contends only that "courts diverge as to whether creditors who seek a setoff against a recovery sought by a trustee lose their jury trial rights, and they disagree about whether a creditor who has not filed a claim and who is sued by the estate can lose its jury trial rights by filing a counterclaim against the estate." Pet. at 32 (footnotes omitted). But neither of those issues is raised by the facts of this case.

(*In re Cambridge Biotech Corp.*), 186 F.3d 1356, 1372 (Fed. Cir. 1999) (finding no right to jury trial on counterclaim arising under patent laws in response to proof of claim for patent infringement and stating that "[t]he precedent is clear that once a party invokes the core jurisdiction of the bankruptcy court by filing a proof of claim, that party has no Seventh Amendment right to a jury trial"). Accordingly, there is no conflict among the courts of appeals that requires resolution.

III. THERE IS NO REASON TO REVISIT *KATCHEN, GRANFINANCIERA,* AND *LANGENKAMP*

A. The Second Circuit's Decision Involves A Straightforward Application Of *Katchen, Granfinanciera,* And *Langenkamp*

The Seventh Amendment applies only to "Suits at common law." U.S. CONST. AMEND. VII. This Court has "consistently interpreted the phrase 'Suits at common law' to refer to 'suits in which *legal* rights were to be ascertained and determined, in contradistinction to those where equitable rights alone were recognized, and equitable remedies were administered.'" *Granfinanciera*, 492 U.S. at 41 (citation omitted) (emphasis in original).

A bankruptcy proceeding is inherently equitable because it necessarily involves creditors' competing claims to assets of a debtor which are insufficient to satisfy all the claims. National Bankruptcy Review Commission, REPORT OF OCT. 20, 1997 707 (1997)

("Report") ("[B]ankruptcy is a collective proceeding to determine the status of a number of obligations affecting several or many diverse parties."). It follows that each creditor's legal remedies are inadequate.

Acting pursuant to its express powers under Section 8 of Article I, Congress created the bankruptcy system to equitably and efficiently distribute debtors' assets among competing creditors so that creditors and reorganizing debtors could emerge from bankruptcy as quickly and efficiently as possible. *Katchen*, 382 U.S. at 328; *see also* Report at 708 ("[T]he very essence of a bankruptcy case requires prompt resolution."). As a result, claims filed by creditors to the debtor's assets are equitable claims to which the Seventh Amendment jury trial right does not attach. *See Katchen*, 382 U.S. at 336 ("The Bankruptcy Act, passed pursuant to the power given to Congress by Art. I, § 8, of the Constitution to establish uniform laws on the subject of bankruptcy, converts the creditor's legal claim into an equitable claim to a pro rata share of the *res*.").

1. Applying these principles in *Katchen*, *Granfinanciera*, and *Langenkamp*, this Court has drawn a "clear distinction" regarding the applicability of the Seventh Amendment to a bankruptcy trustee's claims seeking affirmative relief against a creditor. *Langenkamp*, 498 U.S. at 45. "[U]nder the Seventh Amendment, a creditor's right to a jury trial on a bankruptcy trustee's preference claim depends upon whether the creditor has submitted a claim against the estate . . . ." *Granfinanciera*, 492 U.S. at 58; *Langenkamp*, 498 U.S. at 45 (same).

Thus, when a creditor has submitted a proof of claim, as explained below, the trustee's claim becomes part of the equitable claims allowance process and the Seventh Amendment does not apply. *Langenkamp*, 498 U.S. at 44-45; *Katchen*, 382 U.S. at 336-37. When a creditor has not asserted a proof of claim, the trustee's claim is legal in nature and the Seventh Amendment applies. *Granfinanciera*, 492 U.S. at 55.

In *Katchen*, the Court held that a trustee's claim to recover a preference, which also was asserted as an objection to a creditor's proof of claim, could be tried by the bankruptcy referee in a summary proceeding without a jury even though "if a creditor who has received a preference does not file a claim in the bankruptcy proceeding . . . , the trustee may recover the preference only by a plenary action . . . and in a plenary action in the federal courts the creditor could demand a jury trial . . . ." *Katchen*, 382 U.S. at 327-28 (citations omitted).

Central to the Court's reasoning was the vital importance of the inherently equitable claims allowance and disallowance process to an efficient bankruptcy system. The "power to allow or to disallow claims includes 'full power to inquire into the validity of any alleged debt or obligation of the bankrupt upon which a demand or a claim against the estate is based," which "'is essential to the performance of the duties imposed upon [the bankruptcy court.]'" *Id.* at 329 (citations omitted). Further, "as the proceedings of bankruptcy courts are inherently proceedings in equity, . . . there is no Seventh Amendment right to a jury trial for determination of objections to claims,

including [those to recover preferences]." *Id.* at 336-37 (citations omitted).

2. Given that jury trial rights do not attach to a trustee's objection to a creditor's claim – and we do not understand E&Y to argue to the contrary – *Katchen*'s key insight was that "it makes no difference" from a Seventh Amendment perspective whether a trustee asserts his claim only as an objection or also seeks affirmative relief. As the Court noted, "we have held that equity courts have power to decree complete relief and for that purpose may accord what would otherwise be legal remedies." *Id.* at 338.

Equally important, the resolution of issues in the equitable claims allowance process made a jury trial "unnecessary" because of the "res judicata effect to which that determination [in the equitable process] would be entitled." *Id.* at 339. For these reasons, *Beacon Theatres* and *Dairy Queen* did not mandate that a creditor was entitled to a jury trial on legal issues arising in the claims allowance process prior to any equitable determination in the bankruptcy court because that would require that "*proceedings on allowance of claims must be suspended* and a plenary suit initiated," which would "dismember a scheme which Congress has prescribed" to ensure "the prompt trial of a disputed claim without the intervention of a jury." *Id.* (emphasis added).

3. Since *Katchen*, this Court has twice affirmed the primacy of the claims allowance process in bankruptcy proceedings and the crucial distinction in any Seventh Amendment analysis between resolution

of legal issues that are intertwined in that process and those that are not.

In *Granfinanciera*, the Court held that a creditor was entitled to a jury trial of a bankruptcy trustee's fraudulent conveyance claim where the creditor had not asserted a proof of claim in the bankruptcy proceeding. A trustee's claim in that circumstance "does not arise 'as part of the process of allowance and disallowance of claims.' Nor is that action integral to the restructuring of debtor-creditor relations." *Granfinanciera*, 492 U.S. at 58.

In *Langenkamp*, which was decided under the Bankruptcy Amendments and Federal Judgeship Act of 1984, 28 U.S.C. §§ 151 et seq. ("1984 Act"), the Court reaffirmed *Katchen* and held that when a creditor asserts a claim in bankruptcy and is "met, in turn, with a preference action from the trustee, that action becomes part of the claims-allowance process which is triable only in equity." *Langenkamp*, 498 U.S. at 44. A creditor's claim and the ensuing preference action by the trustee "become integral to the restructuring of the debtor-creditor relationship through the bankruptcy court's *equity jurisdiction*." *Id.* (emphasis in original).

The principles set forth in *Katchen* and *Granfinanciera* and reaffirmed in *Langenkamp* remain vital to the functioning of the bankruptcy courts today. Indeed, in the 1984 Act, Congress assigned the bankruptcy courts jurisdiction of "core proceedings" that included not just "allowance or disallowance of claims against the estate," but also "counterclaims by the estate against persons filing claims against the estate." 28 U.S.C. § 157(b)(2)(B), (C).

4. After E&Y asserted its proof of claim, resolution of the CBI Claims, like resolution of the preference claims at issue in *Katchen* and *Langenkamp*, was necessary to the bankruptcy court's performance of its essential equitable function to allow or disallow the proof of claim.

Thus, the district court and the Second Circuit both found, like the preference claims at issue in *Katchen* and *Langenkamp*, that the CBI Claims constituted a defense to E&Y's proof of claim and therefore the intertwined legal issues had to be resolved as part of the claims allowance process that is indisputably equitable in nature. As the Second Circuit stated, "[a]s defenses to E & Y's fees claim, these CBI claims also directly affect the allowance of that claim" and "[a]ll of these [CBI] claims affect *one of the most elemental of all core bankruptcy functions*: determining if a creditor may collect from a debtor's estate." App. 52a (emphasis added); *see also* App. 51a ("CBI's claim for expungement of E&Y's Proof of Claim . . . directly affects the allowance of E&Y's claim against CBI's estate."). The district court likewise found that the CBI Claims "inevitably impact[ ] on the allowance or disallowance of E&Y's Proof of Claim" because "E&Y's Proof of Claim will be disallowed if BSI's lawsuit is successful." App. 148a.

In light of those facts, the Second Circuit's holding constitutes a straightforward application of *Katchen*, *Granfinanciera*, and *Langenkamp*. Under those authorities, E&Y was not entitled to a jury trial on the CBI Claims because resolution of those Claims

became "part of the claims-allowance process which is triable only in equity." *Langenkamp*, 498 U.S. at 44.[4]

B. E&Y's Contention That *Katchen* Should Be Overruled Does Not Warrant Certiorari

With respect to its first question presented, E&Y contends that this Court should grant certiorari to overrule *Katchen* to the extent that it held that "the ordinary rule that legal claims must be resolved by a jury before factually-related equitable claims are tried to the court – does not apply in bankruptcy." Pet. at 13. E&Y claims that holding was "a product of the archaic bankruptcy regime in place at the time, under which law and equity were divided and overlapping factual and legal claims could not be addressed in a single forum." *Id.* According to E&Y, that rationale no longer applies under the current bankruptcy regime put in place by the 1984 Act. E&Y concludes that, under this Court's holdings in *Lytle v. Household Manufacturing, Inc.*, 494 U.S. 545

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[4] Justice White, who authored *Katchen*, rejected the proposition that *Katchen* is limited to claims by a trustee invoking its avoiding powers. In his dissent in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, Justice White stated: "We also recognized [in *Katchen*] that the referee could adjudicate counterclaims against a creditor who files his claim against the estate. . . . Hence, if Marathon had filed a claim against the bankrupt in this case, the trustee could have filed and the bankruptcy judge could have adjudicated a [breach of contract] counterclaim seeking the relief that is involved in these cases." 458 U.S. 50, 99-100 (1982) (White, J., dissenting).

(1990), *Beacon Theatres*, and *Dairy Queen*, it was entitled to a jury trial of the TCW Claims prior to a bench trial of the CBI Claims. Pet. at 14-15. We begin first with E&Y's *Lytle* argument because, as a threshold matter, E&Y has failed to demonstrate that these cases are even applicable to the unique facts of this case.

1. The Court's Decision In *Parklane Hosiery*, And Not *Lytle*, Governs This Case Because The CBI And TCW Claims Are Now Separate Lawsuits

This case does not raise an issue concerning the application of *Lytle*, *Beacon Theatres*, and *Dairy Queen* in the bankruptcy context. In *Lytle*, as in *Beacon Theatres* and *Dairy Queen*, a single plaintiff asserted both equitable and legal claims in a single proceeding arising out of the same set of facts, which "[the plaintiff] was required to join . . . to avoid the bar of res judicata." *Lytle*, 494 U.S. at 552. After the trial court erroneously dismissed the legal claims, it tried the equitable claims without a jury. This Court held that, under the rule of *Beacon Theatres* and *Dairy Queen*, the plaintiff was entitled to a jury trial on his erroneously dismissed legal claims prior to a trial of his companion equitable claims. *Id.* at 554.

By contrast, in this case, BSI asserted claims in two separate capacities – as successor to CBI and as assignee of TCW. As E&Y itself acknowledged in the bankruptcy court, "for all purposes in this proceeding, BSI is the equivalent of CBI and TCW, and in assessing the sufficiency of the evidence and the applicability of the relevant law, *it is as if CBI and*

TCW were themselves the plaintiffs." Proposed Findings of Fact and Conclusions of Law of Defendants Ernst & Young and Ernst & Young LLP for the Liability Phase of the Trial at 4, ¶ 15, No. 96-09143-BRL (Dkt. No. 78), (Bankr. S.D.N.Y Dec. 3, 1999) (emphasis added).

By holding that E&Y was entitled to a jury trial on the TCW Claims, but not the CBI Claims, the district court and court of appeals recognized that the CBI and TCW Claims effectively are separate claims on behalf of separate parties, *i.e.*, unlike in *Lytle*, these claims could not be rejoined in a single lawsuit but had to proceed independently. As a result of those holdings, the CBI and TCW Claims are now pending as *separate* lawsuits, effectively on behalf of *separate* parties, in *separate* proceedings as the district court and Second Circuit concluded they should have been from the outset.

Where, as here, separate plaintiffs' legal and equitable claims arising from common facts against the same defendant are pending in separate actions, as this Court held in *Parklane Hosiery Co., Inc. v. Shore*, "an equitable determination can have collateral estoppel effect in a subsequent legal action and . . . this estoppel does not violate the Seventh Amendment." 439 U.S. 322, 335 (1979). The application of principles of collateral estoppel to the TCW Claims based on a judgment entered on the CBI Claims after a bench trial does not violate the Seventh Amendment under *Parklane* because "[a]t common law, a litigant was not entitled to have a jury determine issues that had been previously adjudicated . . . in equity." *Id.* at 333.

Accordingly, the rule of *Beacon Theatres*, *Dairy Queen*, and *Lytle* does not apply under the facts of this case and there is no reason to grant the petition for certiorari to consider the operation of that rule in bankruptcy.

2. The 1984 Bankruptcy Act Has Not Undermined *Katchen*'s Rationale

Even if E&Y's first question presented were raised by the facts of this case, the Petition should be denied. E&Y's argument proceeds from the mistaken premise that *Katchen* was "a product of the archaic bankruptcy regime in place at the time, under which law and equity were divided and overlapping factual and legal claims could not be addressed in a single forum." Pet. at 13. E&Y contends this regime was changed by the 1984 Act, which vested bankruptcy jurisdiction in the district courts and which "brought about the merger of law and equity in bankruptcy proceedings." Pet. at 19. In other words, according to E&Y, this Court intended *Katchen* to "be treated like a restricted railroad ticket, 'good for this day and train only.'" *County of Wash. v. Gunther*, 452 U.S. 161, 183 (1981) (Rehnquist, J., dissenting).

To the contrary, under the Bankruptcy Act of 1898, 11 U.S.C. §§ 1 et seq. (repealed 1979) (the "1898 Act"), just as now under the 1984 Act, a single forum (the district court) was available in which all the equitable and legal claims in *Katchen* could have been adjudicated. Under the 1898 Act, the "duties of the bankruptcy court were carried out by 'bankruptcy referees' (later called 'judges'), appointed by the district court." *In re United Miss. Bank of Kan. City, N.A.*, 901 F.2d 1449, 1452 n.9 (8th Cir. 1990). Under

section 22a of the 1898 Act, as now, "[u]nless the judge or judges direct[ed] otherwise," bankruptcy cases were referred by the clerk of the court to a referee, (11 U.S.C. § 45) and "[t]he judge retained power to revoke a reference at his discretion . . . ." 2 COLLIER ON BANKRUPTCY ¶ 22.01 (14th ed.).[5]

As to the district courts, as the *Katchen* Court itself acknowledged, at the time of that decision, the district court was expressly granted jurisdiction over plenary actions by trustees to recover preferences: Section 60 of the 1898 Act "dealing with preferences and their voidability, confers concurrent jurisdiction on state courts and the federal bankruptcy courts to entertain plenary suits for the recovery of preferences." *Katchen*, 382 U.S. at 331.[6]

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[5] E&Y's contention is also belied by the fact that in *Langenkamp*, after enactment of the 1984 Act, the Court re-affirmed *Katchen* without limitation. Although the *Langenkamp* Court did not expressly address the *Beacon Theatres* rule, according to E&Y, the issue is necessarily raised in any case like *Langenkamp* in which the trustee seeks affirmative relief. Pet. at 21 n.4 (explaining that "even viewing the CBI claims on a standalone basis . . . preservation of jury trial rights would require the jury trial to go first" because the CBI Claims "involve legal causes of action triable to a jury (the counterclaims) and overlapping issues constituting defenses to E&Y's claim (triable to the court)").

[6] Section 23 of the 1898 Act provided generally that actions by the trustee could only be commenced in a court where the bankrupt "might have prosecuted them if proceedings in bankruptcy had not been instituted." 1898 Act § 23, 11 U.S.C. § 46. But Section 60(b) created an exception for preference actions, which Congress

In that capacity – "federal bankruptcy courts" with the power to "entertain" plenary actions, *id.*, – district courts exercised equitable *and* legal powers unavailable to referees in resolving the kinds of preference actions at issue in *Katchen*. *See* James Angell MacLachlan, *Protection And Collection of Property of Bankrupt Estates,* 39 MINN. L. REV. 626, 634, 645 (1955) (explaining that, unlike a district court, a "bankruptcy court"; i.e., a referee in bankruptcy, "is not organized to try a plenary suit . . . . "). No less an authority than Collier dismissed the argument now so heavily relied upon by E&Y that "district courts when sitting as bankruptcy courts act[ed] as 'separate and distinct courts'" (and thus purportedly could not simultaneously exercise plenary and summary jurisdiction under the 1898 Act). 1 COLLIER ON BANKRUPTCY ¶ 1.10[4] (14th ed.). In fact, Collier characterized that argument as a "broad pronouncement[ ]" liable to "express mere half-truths and [which did] not answer concrete issues." *Id.*

As E&Y notes, "[i]n 1938, the Federal Rules merged district courts' law and equity jurisdictions." Pet. at 17. Thus, at the time of *Katchen*, as now, a single unified court (the district court) was available to consider all the equitable and legal claims at issue in a single proceeding. *Katchen*'s paramount concern in rejecting application of *Beacon Theatres* notwithstanding the existence of a district court forum for providing jury trials in bankruptcy proceedings on

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permitted to be brought in the district courts even if there was no independent basis for federal subject matter jurisdiction. *Id.* at § 60(b), 11 U.S.C. § 96.

preference claims – that jury trials would interfere with the claims allowance process by causing "delay and expense" and "dismember[ing]" the Congressional scheme – remains as vital as ever. 382 U.S. at 339.

C. E&Y's Contention That *Katchen* Should Be Limited To Claims In Which A Trustee Invokes Avoiding Powers Does Not Warrant Certiorari

With respect to the second question presented, E&Y contends that this Court should grant certiorari to limit the holdings of *Katchen*, *Granfinanciera*, and *Langenkamp* to apply only to claims involving a bankruptcy trustee's avoiding powers, but not to a bankruptcy trustee's compulsory counterclaims arising under common law. As demonstrated below, E&Y's argument is based on an artificial distinction unsupported by the rationale that E&Y offers to justify it.

1. There Is No Principled Seventh Amendment Distinction Between Avoiding Powers Claims And Compulsory Common Law Counterclaims

Under E&Y's theory, the Seventh Amendment is inapplicable to a trustee's claim to recover a fraudulent conveyance from a creditor which filed a proof of claim. Pet. at 26-27. Fraudulent conveyance claims "are quintessentially suits at common law that more nearly resemble state-law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res." *Granfinanciera*, 492 U.S. at 56. As such,

trustees' fraudulent conveyance claims are indistinguishable from the compulsory common law counterclaims at issue.[7]

As to preference avoidance actions, while not rooted in the common law in the manner of fraudulent conveyance claims, nonetheless, where, as here, a creditor has submitted a proof of claim, there is no meaningful difference between an objection and a claim to recover a preference (or based on any other avoiding power) and an objection and compulsory counterclaim that arises from common law *and* from the same underlying facts as the proof of claim. *See Katchen*, 382 U.S. at 330 (holding that a trustee's "objection under § 57, sub. g is, like *other objections*, part and parcel of the allowance process" (emphasis added)). In either case, a proof of claim "can neither be allowed nor disallowed" without resolving the trustee's claim. *Id.*[8]

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[7] Nor does the Seventh Amendment analysis turn on 11 U.S.C. § 502(d) (formerly § 57(g) of the 1898 Act, 11 U.S.C. § 93), which provides that a creditor's claim cannot be allowed until the creditor returns a fraudulent conveyance (or preference). Congress cannot deprive a creditor of a jury trial on a "quintessential" suit at common law simply by codifying the common law fraudulent conveyance claim and then decreeing that the creditor must forfeit its jury trial right on the claim as the price of access to the one forum available in which to prosecute the creditor's claim against the debtor.

[8] *Accord In re Iridium Operating LLC*, 285 B.R. 822, 834 (S.D.N.Y. 2002) (counterclaims to a creditor's proofs of claim, including those arising under common law, "can affect whether the bankruptcy should allow or disallow

Adopting E&Y's position and requiring jury trials of compulsory common law counterclaims would disrupt the Congressionally-created bankruptcy scheme. "Objections to claims . . . almost always involve state law." 1 COLLIER ON BANKRUPTCY ¶ 3.02[6][a] (15th ed. rev.). *See In re Grabill Corp.*, 976 F.2d 1126, 1126 & n.1 (7th Cir. 1992) ("[J]ury trials are the very antithesis of the speedy bankruptcy procedure. . . . Evidence that jury trials would bog down a system designed for quick resolution of matters may be found from examining the jury trial backlog in the district courts.").

As the *Katchen* Court noted, "many incidental questions arise in the course of administering the bankrupt estate, which would ordinarily be pure cases at law," otherwise triable by jury. In bankruptcy proceedings, "they become cases over which the bankruptcy court, which acts as a court of equity, exercises exclusive control." *Katchen*, 382 U.S. at 337. Pertinent here, a "claim of debt or damages against the bankrupt is investigated by chancery methods." *Id.* (internal citation omitted).

Accordingly, the rationale of *Katchen*, *Granfinanciera*, and *Langenkamp* supports the same result in this case in which the CBI Claims became "part of the claims allowance process" and "integral to the

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claims against the estate"); *Union Carbide Corp. v. Viskase Corp. (In re Envirodyne Indus., Inc.)*, 183 B.R. 812, 819 (Bankr. N.D. Ill. 1995) ("A counterclaim that serves as the basis of an objection to a claim is an integral part of the claims allowance process in . . . bankruptcy." (internal quotations omitted)).

restructuring of the debtor-creditor relationship through the bankruptcy court's *equity jurisdiction*." *Langenkamp*, 498 U.S. at 44 (emphasis in original).[9]

2. E&Y's Proposed Distinction Is At Odds With Its Supposed Rationale

To justify its proposed distinction between claims invoking a trustee's avoiding powers and compulsory counterclaims invoking common law, E&Y seeks to impose a construct on *Katchen*, *Granfinanciera*, and *Langenkamp* that finds no support in those decisions or any other authoritative source. According to E&Y, "a bankruptcy trustee's avoiding power objections are equitable in a way that a debtor's other claims are not" because the trustee's avoiding powers are "a bankruptcy-tailored application of a familiar equity maxim: those who seek equitable relief must enter courts of equity with 'clean hands'; they must not have acted in a manner that offends equity." Pet. at 26, 23. In other words,

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[9] In *Katchen*, this Court stated that its holding in *Alexander v. Hillman*, 296 U.S. 222 (1935) "in connection with the jurisdiction of a receivership court to entertain a counterclaim for forfeiture against a claimant in the receivership proceeding, is equally applicable" in the bankruptcy context. *Katchen*, 382 U.S. at 335. The *Katchen* Court further cited with approval decisions from the courts of appeals that had construed *Hillman* to authorize bankruptcy courts to "grant affirmative relief on related counterclaims that would also be defenses to the [creditor's] claim" without a jury trial on such claims, including cases that involved common law counterclaims. *Id.* at 336 n.12 (citing, *e.g.*, *In re Solar Mfg. Corp.*, 200 F.2d 327, 331 (3d Cir. 1952); *Florance v. Kresge*, 93 F.2d 784, 786 (4th Cir. 1938)).

according to E&Y, the process by which preference holders are purged of their purported sins is outside the scope of the Seventh Amendment, unlike the CBI objection in the form of a compulsory counterclaim based on the creditor's tortious harm to the debtor that is inextricably intertwined with resolution of the E&Y proof of claim.

Whatever its theological merits, as an interpretation of the Seventh Amendment, E&Y's "original sin" theory has no doctrinal support and misapprehends the nature of preferences and fraudulent conveyances. A party seeking to invoke the unclean hands doctrine must establish that "the suitor seeking the aid of a court of equity has *himself* been guilty of conduct in violation of the fundamental principles of equity jurisprudence . . . ." 1 POMEROY'S EQUITY JURISPRUDENCE § 397 (3d ed. 1905) (emphasis added). That doctrine is irrelevant to preference avoidance actions: "the most striking feature of a preference claim is that it requires *no showing that the creditor has done wrong* – only that the creditor received payment from the debtor on a legitimate debt." Benjamin R. Norris, *Bankruptcy Preference Actions*, 121 BANK. L. J. 483, 483 (2004) (emphasis added); *see* 5 COLLIER ON BANKRUPTCY ¶ 547.01 (15th ed. rev.) ("[I]t is the *effect* of the transaction, rather than the debtor's or creditor's *intent*, that is controlling." (emphasis in original)). At the very least, E&Y's proposed rationale does not justify an irrebuttable presumption that all preference holders are guilty of "unclean hands."

Nor is E&Y's rationale easily applied to creditors who received fraudulent conveyances. The

authority cited by E&Y actually points out that preference and fraudulent conveyance actions have *conceptually distinct* rationales. *See* Thomas H. Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725 (1984). Unlike preference actions, which "adjust the rights of creditors vis-à-vis other creditors, fraudulent conveyance law adjusts the rights of creditors vis-à-vis the debtor." *Id.* at 726 (fraudulent conveyance law is "not an offspring of, nor particularly related to, the bankruptcy process itself.").

In those regards, fraudulent conveyance actions bear a far greater resemblance to the common law counterclaims at issue in this case than they do to preference actions. In other words, E&Y's proposed "unclean hands" rationale also fails to explain why a creditor, such as E&Y, which is alleged (and found by the bankruptcy court) to have been responsible for causing CBI's bankruptcy, should be entitled to a jury trial but not a creditor who simply received a fraudulent conveyance.

Ironically, E&Y's proposal would advantage creditors alleged to have harmed the debtor's estate over those not alleged to have done so. Thus, those creditors which filed a proof of claim and against which the trustee asserted common law counterclaims based on their allegedly tortious conduct would be entitled to a jury trial on their proof of claim, while all other creditors would not. There is no reason to promote that anomalous result.

Moreover, although E&Y claims that the construct it seeks to impose on *Katchen* would work a "recalibrat[ion]" of the current bankruptcy regime, if adopted, it would fundamentally alter the bankruptcy

process. Pet. at 3. E&Y is asking the Court to replace *Katchen*'s well-settled and well-reasoned holding with an amorphous test that would afford jury trial rights to "innocent" preference holders but not to those with "unclean hands," because the latter lack standing to seek equitable relief in the form of a distribution in bankruptcy until they have returned the preference. Adopting E&Y's model would impose a crushing burden on the bankruptcy system because, in the absence of an irrebuttable presumption, bankruptcy courts would have to conduct a threshold inquiry on a creditor-by-creditor basis into whether a trustee's avoiding powers claim in response to a creditor's proof of claim implicates the creditor's unclean hands.

Simply put there is no support for E&Y's conclusion that "[v]iewing avoiding-power objections as invocations of unclean hands doctrine reveals why the filing of a proof of claim carries so much weight in this Court's Seventh Amendment analysis of avoiding-power claims." Pet. at 29.

3. The *Langenkamp* Decision Was Not Doctrinally Confused

Perhaps because the Second Circuit's decision follows plainly from *Langenkamp*, which was decided after the 1984 Act was enacted, E&Y describes that decision variously as "opaque" (Pet. at 25), "unclear" (Pet. at 30) and responsible for "doctrinal confusion caused by [its] oblique reference to the public rights doctrine." Pet. at 30. E&Y refers specifically to the language in *Langenkamp* quoting *Granfinanciera's* "holding that 'the creditor's claim and the ensuing preference action by the trustee become integral to

the restructuring of the debtor-creditor relationship through the bankruptcy court's *equity jurisdiction*.'" Pet. at 30.

E&Y admits that "a majority of the Court expressed doubt that the restructuring of the debtor-creditor relationship is a public right." Pet. at 31 (citing *Granfinanciera*, 492 U.S. at 56 n.11). Thus, there is no basis for E&Y's conclusion that "[o]ne could read [*Langenkamp*] to mean that the restructuring of debtor-creditor relations is a public right, and further that there is no right to a jury trial on any issue that Congress assigns to the bankruptcy court's 'equity jurisdiction' – whatever that may be." Pet. at 31. E&Y nevertheless labels references to that language in *Langenkamp* and in the Second Circuit's opinion relying on *Langenkamp* as "public rights language" and concludes from that faulty premise that the Second Circuit "seemed puzzled" and that the unanimity among other courts regarding the Second Circuit's holding shows that those courts "share the Second Circuit's confusion." Pet. at 31. E&Y's circular logic, in which a faulty conclusion is derived from a faulty premise, does not provide a basis for granting certiorari.

D. E&Y's Contention That The Seventh Amendment Requires A Jury Trial Of Discrete Issues Of The CBI Claims Does Not Warrant Certiorari

Alternatively, E&Y contends that this Court should grant certiorari to determine whether "it is consistent with the Seventh Amendment to have a bench trial of *all* issues presented by a partially overlapping claim or only the overlapping issues." Pet. at 34 (emphasis in original). But E&Y's contention fails at its inception because both of the alleged jury triable issues "bore directly on allowance or disallowance of E&Y's claim." Pet. at 33-34.

First, E&Y contends that it was entitled to a jury trial on the application of "the *in pari delicto* doctrine that would ordinarily bar the CBI claims." Pet. at 33. E&Y's contention formed the basis for its argument that BSI lacked standing to assert the CBI Claims. Because the CBI Claims served as a defense to E&Y's proof of claim, E&Y's standing argument would have negated that defense and therefore had to be resolved in the claims allowance/disallowance process. Indeed, that is precisely what the district court held when it erroneously dismissed the CBI Claims on the ground that BSI lacked standing to assert them. App. 81a ("Because CBI's claim for expungement of Ernst & Young's Proof of Claim is premised upon CBI's allegations of fraud, breach of contract, and negligence, CBI's expungement claim necessarily fails").

Second, E&Y contends that it was entitled to a jury trial on "the amount of damages suffered by CBI as a result of any alleged malpractice by E&Y." Pet.

at 33. E&Y argues essentially that even if the bankruptcy court had the right under *Katchen*, *Granfinanciera*, and *Langenkamp* to consider whether CBI suffered damages up to the point that those damages offset E&Y's claim, once that point was reached the bankruptcy court should have stopped its analysis and referred the remaining calculations to the district court so that E&Y might have been afforded a jury trial on the issues that did not "overlap" with the claim allowance/disallowance process. Pet. at 34.

Putting aside the fact that E&Y's alternative theory would turn the district courts into damages assessment adjuncts of the bankruptcy courts, the damages issue in this case also bore directly on, and was inextricably part and parcel of, the allowance or disallowance of E&Y's proof of claim. In light of the damages methodology required in this specific case, which neither party disputed, the bankruptcy court could not determine whether CBI's quantified damages at least equaled the amount sought by E&Y in its proof of claim without determining the full amount of CBI's damages.

There was no dispute that CBI's damages should be measured by the fair market value of its business before destruction. Both sides agreed that the first step in the damages calculation was to determine CBI's "enterprise value" by "multiplying its annual sales by a chosen sales multiple." BSI App. 9a. Both sides also agreed that the second step was to calculate CBI's equity or fair market value by deducting certain balance sheet items from enterprise value.

E&Y argued that the appropriate sales multiple would lead to a determination that CBI had suffered no damages as a result of E&Y's negligence. The bankruptcy court ultimately did not accept that sales multiple or the sales multiple offered by BSI's expert and agreed with E&Y on the appropriate deductions. BSI App. 9a-10a, 13a. But it was necessary for the bankruptcy court to undertake each of these steps to quantify CBI's actual damages and thus to determine whether those damages at least equaled E&Y's proof of claim. And, once the bankruptcy court completed that analysis, the amount of CBI's damages was determined by a simple calculation. BSI App. 14a. Put another way, given the formula used to determine whether CBI suffered any damages, the bankruptcy court could not simply have stopped counting once the damages reached the amount of E&Y's proof of claim.

Thus, as in *Katchen*, "all of the substantial factual and legal bases" supporting the CBI Claims were "disposed of in passing on objections to" E&Y's proof of claim. *Katchen*, 382 U.S. at 333 n.9.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

GREGORY J. WALLANCE
Counsel of Record
RICHARD G. SMOLEV
ROBERT GRASS
ELISABETH KANN
AARON MINER
LAUREN ATTARD
KAYE SCHOLER LLP
425 Park Avenue
New York, New York 10022
(212) 836-8000

Attorneys for Respondent
Bankruptcy Services, Inc.,
now doing business as
Epiq Bankruptcy Solutions, LLC

March 19, 2009

APPENDIX

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

Chapter 11
Case No. 94 B 43819 (BRL)
Adv. P. No. 96-9143A

In re

CBI HOLDING COMPANY, INC. *et. al.*,

Debtors,

BANKRUPTCY SERVICES, INC.,

Plaintiff,

—against—

ERNST & YOUNG, & ERNST & YOUNG, LLP.

Defendants.

CORRECTED ERRATA ORDER

ORDERED that the Findings of Fact and Conclusions of Law Pursuant to Rule 7052 dated October 23, 2000, be changed as follows:

page 10, paragraph 28, replace "July 3" with "July 31" and

page 15, paragraph 4, replace "July 3" with "July 31" and

page 15, paragraph 5, replace "$37,718,123" with "$24,790,820."

Dated: New York, New York
November 8, 2000

/s/ Burton R. Lifland
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

Chapter 11
Case No. 94 B 43819 (BRL)
Adv. P. No. 96-9143A

In re

CBI HOLDING COMPANY, INC. *et. al.*,

Debtors,

BANKRUPTCY SERVICES, INC.,

Plaintiff,

—against—

ERNST & YOUNG, & ERNST & YOUNG, LLP.

Defendants.

APPEARANCES:

KAYE, SCHOLAR, FIERMAN,
HAYS & HANDLER, LLP
Attorneys for Plaintiff
425 Park Avenue
New York, New York 10022
(212) 836-8643

By: Jay G. Strum, Esq.
Arthur Steinberg, Esq.
Robert B. Bernstein, Esq.

SCHULTE ROTH ZABEL LLP
Attorneys for Defendants
900 Third Avenue
New York, New York 10022
(212) 756-2000
By: Irwin J. Sugarman, Esq.
Harry S. Davis, Esq.
Howard O. Godnick, Esq.

Before: Burton R. Lifland,
United States Bankruptcy Judge

FINDINGS OF FACT AND CONCLUSIONS OF LAW PURSUANT TO RULE 7052

The following constitutes this Court's findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure. Reference is made to this Court's prior Findings of Fact and Conclusions of Law dated April 5, 2000, and reported at 247 B.R. 347 (Bankr. S.D.N.Y. 2000), with respect to the liability phase of the bifurcated trial of this case, all of which are incorporated by reference herein, and will not be repeated.

Pursuant thereto, this Court entered its Order dated April 18, 2000, ordering that the said Findings of Fact and Conclusions of Law shall constitute the Court's Decision and Judgment as to liability, including the element of causation, and including E&Y's

affirmative defenses relating to the comparative or contributory negligence or proportional fault of the parties other than E&Y.[1]

Pursuant to the Pre-Trial Order For Damages Phase dated June 12, 2000, the trial on the amount of damages was held on July 31 and August 1, 2000. Plaintiff called one witness and Defendants called one witness. Having considered the evidence, testimonial and documentary, as well as the parties' Proposed Findings of Fact and Conclusions of Law and keeping in mind that a court should not blindly accept findings of fact and conclusions of law proferred by the parties, *see St. Clare's Hospital and Health Center v. Insurance Company of North America*, (*In re St. Clare's Hospital and Health Center*) 934 F.2d 15 (2d Cir. 1991) (citing *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 656 (1964), and having conducted an independent analysis of the law and the facts, this Court makes the following Findings of Fact and Conclusions of Law.[2]

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[1] The Findings of Fact and Conclusions of Law dated April 5, 2000 as to liability, *inter alia*, found auditor malpractice on the part of the defendant and liability to the plaintiff arising therefrom. The liability phase consumed seventeen trial days, produced over 3500 pages of transcript with ten witness called by the plaintiff and nine witnesses called by the defendant.

[2] Before reaching the final trial stage, this proceeding involved and subjected this Court and the District Court to a rather extensive and aggressive litigation strategy by one of the parties as is set forth at length at *Bankruptcy Services, Inc. v. Ernst & Young* (*In re CBI Holding Company, Inc.*), 247 B.R. 341, 347 n.1 (Bankr.S.D.N.Y. 2000).

FINDINGS OF FACT

1. I have previously found that at relevant times in 1993, CBI Holding Company, Inc. ("CBI") could have and would have been sold for a substantial price (Findings of Fact ¶¶ 139-148, Findings of Fact and Conclusions of Law dated April 5, 2000).

2. When the Order Confirming First Amended Joint Plan Reorganization As Modified (DX 506) was entered on August 23, 1995, the value of CBI's equity was $0.

3. The damages suffered by CBI are to be measured by the difference in the amount for which CBI's equity could have been sold in 1993 (i.e., the then value of CBI's equity) and $0.

4. Therefore, in determining the damages suffered by CBI, it is the Court's task to determine the value of CBI's equity as of an appropriate date. I choose to make the determination as of April 30, 1993, because of the availability of audited numbers for net sales, debt, preferred stock and other balance sheet figures, none of which have ever been the subject of controversy.

5. Plaintiff called Robert J. Rock, who testified previously at the liability phase of this trial, as an expert to testify as to the valuation of CBI and damages. I permitted him to testify as an expert on those subjects, finding him qualified by knowledge, skill, experience, training and education, to assist me to understand the evidence and to determine facts in issue. (Rule 702, Federal Rules of Evidence).

6. Defendants called Steven Wiggins, who also testified previously at the liability phase of the trial, as

an expert to testify as to the valuation of CBI and its damages. In his opening statement, counsel for E&Y began:

> "Good morning Your Honor. Your Honor, as Mr. Strum says, the Court has found that had TCW known in October of 1993 that the fixed-charge ratio had been triggered, that TCW would have taken control over CBI and CBI would have been sold at that time for *substantial value.*
>
> Now, we don't of course agree with this finding or that there is any basis for it, *but we do obviously accept it for the purpose of this damage phase of the trial* and we have no intention of retrying the liability portion of the case." (emphasis supplied) (Tr. at 16).[3]

Based on that statement, as well as the evidence adduced at the liability phase of trial, one would have expected E&Y's proposed expert, Dr. Wiggins, to testify that CBI had a value that at the very least was a positive number. I declined to permit Dr. Wiggins to testify as an expert on valuation and damages because I found that his proposed testimony, that in 1993 the value of CBI was a negative number in excess of $11 million, would neither assist me in understanding the evidence nor in determining the facts in issue. (Rule 702 Federal Rules of Evidence). I confirm that finding. (See ¶¶ 36 et seq, supra.)

7. I did, however, find Dr. Wiggins qualified to testify as an expert and offer opinions as to the correct

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[3] References to the trial transcript are denoted by "Tr." followed by the page.

methodology for valuing CBI's equity, based upon his knowledge, training and education. (Rule 702 Federal Rules of Evidence). I confirm that finding.

DAMAGES TO CBI

8. Both experts testified that a proper methodology to valuation generally, and CBI specifically, is the market comparison approach, also known as the guideline company method. (Rock, Tr. at 39-40, 78-79; Wiggins, Tr. at 244-45). The market comparison approach meets the reliability test established by the Supreme Court in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993). The technique can be and has been tested and subjected to peer review and publication. Furthermore, there are standards controlling the application of the technique and the technique enjoys general acceptance by economists and industry professionals. Accordingly, I find the technique to be an appropriate method for valuing CBI as of April 30, 1993.

9. The basic principle underlying the market comparison approach is that the value of one company, known as the "subject" company, may be determined by reference to other similar public companies, referred to as "comparable" or "guideline" companies. (Rock, Tr. at 81-82). First, comparable companies must be selected and next, their enterprise values must be calculated. (*See* Pratt at 207, DX-1239). Valuation multiples for those companies may then be computed by dividing the enterprise values by some relevant economic variable. (*See* Pratt at 207, DX-1239). Dividing the enterprise value by sales results in a sales valuation multiple for the compa-

rable company. (Wiggins, Tr. at 298-99). Both experts utilized this approach with respect to CBI.

10. While both sides agree that CBI's enterprise value is properly determined by multiplying its annual sales by a chosen sales multiple, they disagree on (i) the appropriate sales multiple, and (ii) the precise annual sales figure. Both sides also agree that CBI's interest-bearing debt, among other things, must be subtracted from the enterprise value in order to arrive at the value of equity. The parties disagree, however, on whether "interest-bearing debt" should include both long-term and short-term debt or simply long-term debt.

11. Net sales of CBI for the fiscal year ended April 30, 1993 were $487,686,460. (PX 34).

12. In performing his calculations, Mr. Rock added $90,000,000 to that number, representing the annualized sales of M. Brenner & Co., a company acquired by CBI on April 15, 1993, approximately two weeks before the end of the fiscal year. (PX 203).

13. Dr. Wiggins testified that the inclusion of such Brenner sales is wrong as a matter of methodology. For the reasons to be set forth hereinafter, I accept Mr. Rock's view and include the Brenner sales in the calculation.

14. Turning next to the multiple to be applied to net sales, Mr. Rock, both in his report and testimony concluded that 24% was an appropriate multiple. (PX 19; PX 203 at p. CTRL 000010). He based his opinion on multiples applicable to other companies in the wholesale pharmaceutical industry as calculated by Swiss Bank Corporation, Goldman Sachs, and Salomon Brothers Inc., and as set forth in PX

200, 201 and 202. He also relied on the proposal of FoxMeyer, a company engaged in the wholesale pharmaceutical business, dated June 17, 1994 (PX 179) to acquire the interest of Trust Company of the West ("TCW") in CBI, and the implied multiple therein stated.

15. Dr. Wiggins, through the use of numerous calculations, concluded that a much lower multiple was appropriate.[4] However, of greater assistance to me in coming to a conclusion is the uncontradicted fact that in June, 1994, *after* the revelations concerning the unrecorded liabilities, and *after* E&Y withdrew its opinion with respect to CBI's fiscal 1993 financial statements, FoxMeyer made a proposal to purchase TCW's equity which proposal was based upon a 22% multiple of net sales. However, the FoxMeyer offer was conditioned upon, among other things, the ability of FoxMeyer and its accountants to get comfortable with the internal controls in place, as well as the audit issues. (*See* Ex. 179, FoxMeyer letter, dated June 17, 1994.) Although Mr. Rock opined that because the FoxMeyer proposal of .22 was without audited financials that the value of CBI prior to the revelations must have been higher, I disagree. From the evidence presented, it is clear to this court that the FoxMeyer proposal was conditional upon FoxMeyer receiving satisfactory audited or rather reaudited financials. Without those reaudited financials, the proposal was not sufficiently cohered. However, based upon that proposal, the testimony of both experts and the reports of the investment

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[4] Despite this conclusion, Dr. Wiggins' report notes that CBI was valued by all the relevant contemporaneous actors in mid-1994 for at least 22 percent of net sales. (Tr. 397-98)

banking firms relied upon and dissected by both experts,[5] I find that the appropriate multiple is .22.

16. As a consequence, I find that as of April 30, 1993, CBI had an enterprise value of $127,091,021, resulting from the following calculation:

Fiscal 1993 Net Sales	$487,686,460
Add: Annualized 1993 Sales M. Brenner	90,000,000
Total Net Sales	$577,686,460
Valuation Multiple	0.22
Resulting Value	$127,091,021

17. Both Mr. Rock and Dr. Wiggins agree that the next step in the calculation is to deduct debt. However, while Mr. Rock testified that in the case of CBI, only the long-term debt should be deducted, Dr. Wiggins testified that all debt, long-term and short-term, should be deducted.

18. Mr. Rock testified that CBI's short-term debt was part of its working capital and not part of its capital structure. As a consequence, Mr. Rock opined, to go from CBI's enterprise value to its equity value, one should only deduct the long-term portion of CBI's debt. (Tr. 59-60).

19. Dr. Wiggins testified that enterprise value generally includes short-term debt, and because the investment bankers' calculations in determining appropriate multiples of the comparable companies included short-term debt, CBI's short-term debt

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[5] The Swiss Bank report analyzing comparable companies, calculated the mean at .24 and the median at .22. (Ex. 200) The Goldman Sachs report lists the mean at .25 and the median at .18. (Ex. 201)

should be deducted in order to arrive at its equity value. (Wiggins, Tr. at 301-304; DX-1239, Shannon P. Pratt, Robert F. Reilly, Robert P. Schweihs "Valuing A Business, " at 233). In other words, if a value multiple is computed based on comparable company data defined in a certain way, that multiple should be applied to the fundamental data defined the same way for the subject company. (See Pratt at 236, DX-1239; Wiggins Tr. at 290, 300).

20. Although the experts disagreed on whether short-term debt was included in the investment bankers' calculations for the comparable companies, Mr. Rock admitted that he did not audit the numbers for the comparable companies. Dr. Wiggins, on the other hand, did audit those numbers and determined that short-term debt was included in the calculations for the comparable companies and thus, should be included in the calculations for CBI. Mr. Rock acknowledged that both Swiss Bank and Salomon utilized total debt in their calculations. (Rock, Tr. at 167, 169).

21. Plaintiff challenged Dr. Wiggins' calculations with respect to one of the comparable companies, McKesson Corporation. Looking at the data for McKesson Corporation, Goldman Sachs lists a market capitalization of $2,229,600,000 and a levered market capitalization of $2,632,900,000. Thus, the total of long-term debt, short-term debt and preferred stock, minus cash should equal the difference between $2,632,900,000 and $2,229,600,000 or $403,300,000. However, if one looks at either McKesson Corporation's balance sheet at September 30, 1993, (DX 1266 Tab B at pp. 4, 5 of 19), or at December 31, 1993 (DX 1266 Tab C at pp. 4, 5 of 18), the number derived by

adding short-term debt, the current portion of long-term debt, long-term debt and preferred stock, minus cash in each case is substantially greater than $403.3 million. Dr. Wiggins explained this phenomenon by opining that Goldman Sachs erred by not including preferred stock in arriving at its number for levered market capitalization, or enterprise value. (Tr. 432).

22. I believe Dr. Wiggins is correct. The figures from McKesson Corporation's balance sheet reflect that short-term debt, the current portion of long-term debt and long-term debt minus cash equals approximately $403,300,000.[6] It appears that it was the $125 million of preferred stock that Goldman neglected to deduct. Similarly, a comparison of Goldman Sachs' analysis of Bindley Western Industries' enterprise value and that company's 10-Q demonstrates that the enterprise value was determined by adding its equity value to its *total* debt, including short-term borrowings, net of cash. (DX-1325 at GS00732; DX-1260D at 3). As noted, Mr. Rock admitted that he did not audit the figures in any of the investment bankers' analyses and the plaintiff failed to show that those analyses did not include short-term debt.

23. From the above recited facts, I find that Mr. Rock erred in failing to include short-term debt in his calculations.

24. Accordingly, I find the following deductions of debt appropriate:

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[6] $169.4 million of short-term debt plus $27.5 million current portion of long-term debt plus $291.2 million long-term debt minus $84.8 million cash equals $403.3 million.

Loans Payable to Banks	($78,052,997)
Notes Payable to Related Parties	($19,911,430)
Capital Lease Obligations	($383,974)
Covenants Not To Compete	($1,004,017)

25. These amounts include the long-term bank debt of M. Brenner, which was acquired by CBI on April 15, 1993. It is because of the deduction of this amount that I find it appropriate to include the $90,000,000 of annualized M. Brenner sales. A deduction of the Brenner debt without the inclusion of Brenner sales would produce a distorted calculation.

26. Mr. Rock added back to his calculation $15,520,212 representing the TCW portion of the long-term sub-debt. His reason was that the TCW notes would be separately satisfied by E&Y and therefore should not be deducted in calculating CBI's equity value. I find the add-back to be inappropriate for the reason that if CBI had been sold in 1993 the price paid would not have included such amount.

27. As a consequence, I find, the value of CBI's equity as of April 30, 1993 to be as follows:

Fiscal 1993 Net Sales	$487,686,460
Add: Projected Brenner Sales	90,000,000
Total Net Sales	577,686,460
Valuation Multiple	.22
Resulting Value	$127,091,021
Less: Loans Payable to Banks	(78,052,997)
Less: Notes Payable to Related Parties	(19,911,430)
Less: Capital Lease	(383,974)

Less: Covenants Not to Compete	(1,004,017)
Value of CBI Equity	$27,738,603

28. I find that it is appropriate to add pre-judgment interest pursuant to § 5001 New York CPLR at the rate of 9% simple interest. For the period October 30, 1993, (four days after E&Y issued its opinion, with respect to CBI's fiscal 1993 financial statements) to July 3, 2000 (the first day of trial) such interest amounts to $16,851,201. Thereafter, interest accrues at the statutory rate.

DAMAGES IN RESPECT OF TCW NOTES

29. I have previously found that TCW would have standing to assert its claims against E&Y with respect to its unpaid notes. (Findings of Fact and Conclusions of Law dated April 5, 2000, Conclusions of Law ¶¶ 18-21.)

30. The notes at issue are a note dated May 31, 1991, in the face amount of $15,000,000 issued pursuant to a Securities Purchase Agreement dated May 31, 1991 (PX 103) and a note in the face amount of $750,000 issued pursuant to a Securities Purchase Agreement dated April 14, 1993 (PX 104). The notes are DX 1201 and 1202 respectively. With respect to each note, the parties agree that the last interest payment was made on December 31, 1993.

31. In the liability phase, I found that but for E&Y's malpractice, CBI would have been sold in October 1993. (Findings of Fact and Conclusions of Law dated April 5, 2000, Conclusion of Law ¶ 9). Had

the company been sold at that time, TCW would have received the principal amount of the notes on that date. Thus, damages resulting from TCW's failure to sell the notes must be determined by subtracting any interest payments made after the assumed sale date from the principal amount of the notes and adding statutory prejudgment interest on that amount from the date of sale.

32. Accordingly, I find the damages related to the TCW notes as follows: $15.75 million less $338,000 of interest payments made subsequent to the assumed sale date plus prejudgment interest in the amount of $9,379,457 for a total of $24,790,820.

33. In light of all of the above, I find the damages herein to be as follows:

Damages to CBI	$27,738,603
Interest Pursuant to § 5001 New York CPLR	16,851,201
Amount Due on TCW Notes	24,790,820
Total Damages	$69,380,625

Facts Relating To Defendants' Defenses of Failure to Mitigate Damages

In addition to the Findings of Fact contained in the Findings of Fact and Conclusions of Law dated April 5, 2000, to which I will refer in the Conclusions of Law herein, I make the following findings.

34. The FoxMeyer letters dated June 17, 1994 addressed to CBI c/o Goldman, Sachs did not constitute an offer that either CBI or TCW was free to accept. The letter recites in pertinent part:

> "Our indication of interest is naturally conditioned upon completion of normal business and legal due diligence and customary documentation containing mutually acceptable terms and conditions. More specifically, the ability of FoxMeyer and its accountants to get comfortable with the internal controls in place, as well as the audit issues is critical to the process." (PX 179).

35. After E&Y withdrew its opinion with respect to CBI's fiscal 1993 financial statements, TCW continually and frequently urged E&Y to complete the additional procedures as rapidly as possible. (Testimony of Frank Pados at trial of liability phase, Tr. 1214-1220).

Dr. Wiggins' Testimony

36. I find that the evidence adduced at trial confirmed the correctness of the Court's decision to decline to permit Dr. Wiggins to testify as an expert with respect to valuation and damages. In a number of instances his testimony at the damages phase is squarely contradicted by his expert report, his prior testimony or both. The following examples are illustrative.

37. As earlier stated, Dr. Wiggins proposed to testify that on October 31, 1993, the value of CBI's equity was a negative number in excess of $11 million. This assertion is contradicted by Dr. Wiggins' own words as follows:

a. "Both FoxMeyer and TCW felt the Company was *of substantial value* in June 1994 and the values they assigned were at least as large as one would expect for a company like CBI." (emphasis supplied). (Expert Report of Steven Wiggins, DX 879 ¶ 74, p. 19).

b. In ¶¶ 36 and 37 of his report, Dr. Wiggins stated that the acquisitions of Granain, Blinn, Brenner and Holsin increased CBI's net value by over $80 million and that these values were not ultimately realized because of an allegedly bad decision by TCW.

These statements are totally contradictory of the assertion that on October 31, 1993 the value of CBI's equity was a negative number.

38. Dr. Wiggins testified at the damages phase of the trial that Mr. Rock, in choosing a multiple to be applicable on April 30, 1993, incorrectly looked at multiples derived by Swiss Bank on October 29, 1993, Goldman Sachs on December 28, 1993, and Salomon on September 21, 1994. Dr. Wiggins testified that since the date of calculating the multiple is critical, Mr. Rock's methodology was seriously flawed. However, it was brought out on cross-examination that at his deposition, Dr. Wiggins testified that the multiple applicable to CBI was the same in August 1992, October 1993, January 1994, March 14, 1994 and June 1994. (Tr. 401-8).

39. At trial, Dr. Wiggins testified that in arriving at enterprise value the sales as reported in the most recent public financial statement should be used, apparently in support of his assertion that the sales

of Brenner should not be included. (Tr. at 385). However, in ¶ 80, p. 21 of his expert report Dr. Wiggins stated:

> "This view is highly consistent with industry valuation methods which is to base valuation on next years projected sales."

40. For all of the reasons above-stated, I confirm my decision declining to permit Dr. Wiggins to testify as an expert with respect to valuation and damages while permitting and allowing his testimony as an expert as to the correct methodology for valuing CBI's equity.

CONCLUSIONS OF LAW

1. Where as here, the action is grounded in tort, the appropriate measure of damages in respect of CBI's claim is the difference between what the company could have been sold for in 1993 and the amount realized by the equity holders. *See e.g.*, *SAB Enterprises, Inc. v. Village of Athens*, 164 A.D. 2d 558, 564 N.Y.S.2d 817 (3rd Dep't 1991) (the appropriate measure of damages for tortious acts which destroy a company's business is "the fair market value of the business before destruction").

Having found the value of CBI's equity as of April 30, 1993 to be $27,738,603 (Finding of Fact ¶ 26 *supra*), and having found that when the Order Confirming First Amended Joint Plan of Reorganization As Modified (DX 506) was entered on August 23, 1995, the value of CBI's equity was $0 (Finding of Fact ¶ 2 *supra*), I find the damages, in respect of plaintiff's claim on behalf of CBI to be $27,738,603.

2. New York CPLR § 5001(a) provides that prejudgment interest "shall be recovered" in actions grounded in contract or tort. Subsection "(b)" provides that such interest shall be computed from the earliest ascertainable date the cause of action existed. Here, the cause of action in respect of the CBI claims came into existence no later than October 30, 1993, four days after E&Y issued its opinion with respect to CBI's fiscal 1993 financial statements.

3. New York CPLR § 5004 provides that such interest shall be at the rate of nine percent per annum.

4. As a consequence, I find that plaintiff is entitled to prejudgment interest in respect of $27,738,603 from October 30, 1993. The amount of such interest for the period October 30, 1993 to July 3, 2000, the first day of the damages trial is $16,851,201 with interest accruing at the statutory rate.

5. The appropriate measure of damages on TCW's notes is the unpaid principal less interest payments made subsequent to October 1993 plus statutory interest. The subject notes are DX 1201 and 1202, and the agreements pursuant to which they were issued are PX 103 and 104 respectively. I find plaintiff's damages in respect of the TCW notes to be $37,718.123.

6. One who is injured by the wrongful act or omission of another is required to exercise reasonable efforts to avoid, minimize or lessen the resulting injury. *Wilmot v. State of New York*, 32 N.Y.2d 164 (1973); *Williams v. Bright*, 230 A.D.2d 548, 658 N.Y.S.2d 910 (1st Dept., 1997); *Prudential v. Dewey Ballantine et al.*, 170 A.D.2d 108, 573 N.Y.S.2d 981

(1st Dept., 1991). The plaintiff's duty is to make reasonable efforts and take reasonable measures, but he is under no obligation to take extraordinary or costly measures, or measures the efficacy of which is doubtful *Allen v. McConihe*, 124 N.Y. 342 (1891). *See also*, 36 N.Y. Jur.2d *Damages* §§ 21-23.

7. Defendants assert that each of CBI and TCW failed to mitigate its damages (Defendants' Contentions of Fact ¶¶ 14, 15, Pre-Trial Order For Damages Phase dated June 12, 2000). Thus, in Contention of Fact ¶ 14, defendants assert that TCW failed to mitigate its damages when it failed to accept FoxMeyer's offer in June 1994. In Contention of Fact ¶ 15 defendants assert that CBI and TCW should have sought to ensure the completion of the additional procedures by E&Y or engaged other auditors to issue an opinion on restated financial statements for 1993 and/or audited financial statements for 1994, and that the failure to do so constituted a failure to mitigate damages.

8. I find that neither CBI nor TCW failed to mitigate its damages, based upon the following findings of fact:

a. The FoxMeyer letter dated June 17, 1994 (PX 179) did not constitute an offer that either CBI or TCW was free to accept. (Finding of Fact ¶ 33 *supra*).

b. FoxMeyer requested that E&Y's work papers be provided to its accountants, Deloitte & Touche. Scerra asked Pados to consent to E&Y so providing its work papers, and Pados consented. (Findings of Fact and Conclusions of Law dated April 5, 2000, Finding of Fact ¶ 149).

c. Thereafter, even though Pados consented to Scerra's request, E&Y declined to provide its work papers to Deloitte & Touche. (*Ibid.*, Finding of Fact ¶ 150).

d. One week thereafter, FoxMeyer communicated to TCW that it was no longer interested in pursuing a transaction. (*Ibid.*, Finding of Fact ¶ 151).

e. By letter dated March 12, 1994, E&Y stated to CBI's Board of Directors that its reports with respect to the fiscal 1993 financial statements were being withdrawn and could no longer be relied upon. (*Ibid.*, ¶ 108).

f. Without revealing that E&Y had failed to detect the unrecorded liabilities because it had failed to properly perform the search for unrecorded liabilities, Scerra solicited the reaudit work while asserting to the TCW representatives on CBI's Board of Directors that E&Y was the best firm to undertake a reaudit of CBI's financial statements. (*Ibid.*, ¶ 109).

g. E&Y prepared an audit program for the reaudit two days before E&Y met with the CBI Board of Directors and one day before they withdrew their opinion. (*Ibid.*, ¶ 110).

h. After E&Y withdrew its opinion with respect to CBI's fiscal 1993 financial statements, TCW continually and frequently urged E&Y to complete the additional procedures as rapidly as possible. (Finding of Fact ¶ Findings of Fact and Conclusions of Law dated April 5, 2000, 34, *supra*.).

9. As a consequence, I find that there was no reasonable step or measure available to either CBI or TCW which CBI or TCW failed to take in order to eliminate, minimize or lessen its damages.

10. Under Rule 702 of the Federal Rules of Evidence, if specialized knowledge will "assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, experience, training or education, may testify thereto in the form of an opinion or otherwise."

11. However, before a witness proferred as an expert may be permitted to testify, the court must be satisfied that the proferred testimony will be "sufficiently tied to the facts of the case" so that it will aid the finder of fact in resolving a factual dispute. *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 591 (1993), *citing* Fed. R. Evid. 702.

12. During the *voir dire*, it became apparent that Dr. Wiggins proposed to testify that on October 31, 1993, the value of CBI's equity was a negative number in excess of $11 million. I found that such proposed testimony would be of no assistance to me in resolving the factual issue as to the amount of damages suffered by CBI because it was contrary to the evidence previously adduced in the case to the effect that CBI had a substantial positive value including, *inter alia*, Dr. Wiggins' expert report and prior testimony. The evidence to which I refer includes the following:

a. In June, 1994, both FoxMeyer and TCW attributed a substantial positive value to CBI's equity. (DX 879 ¶ 74, p. 19).

b. In his expert report, Dr. Wiggins stated that the values assigned by FoxMeyer and TCW "were at least as large as one would expect for a company like CBI." (DX 879 ¶ 74, p. 19).

c. In his expert report, Dr. Wiggins stated that the acquisitions of Granain, Blinn, Brenner and Holsin increased CBI's net value by over $80. (DX 879, ¶¶ 36 and 37, p. 10).

13. As a consequence, I confirm my earlier finding that the proferred testimony of Dr. Wiggins would be of no assistance to me in resolving the factual issue as to the amount of damages suffered by CBI.

CONCLUSION

In light of all of the foregoing, I find plaintiff's damages to be as follows:

Damages to CBI	$27,738,603
Interest Pursuant to CPLR § 5001	$16,851,201 (plus an amount to be calculated from July 3, 2000 to the date of entry of judgment.)
Amount Due on TCW Notes	$24,790,820 $69,380,625 plus additional prejudgment

SUBMIT A JUDGMENT CONSISTENT WITH THIS DECISION

Dated: New York, New York
October 23, 2000

/s/ Burton R. Lifland
United States Bankruptcy Judge